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IN THE

Supreme Court of the United States

OCTOBER TERM, 1959.

No. 819

COMMERCIAL CREDIT CORPORATION, a Corporation.
Petitioner.

vs.

C. WYLIE ALLEN, Trustee in Bankruptcy of CROSS-TOWN MOTORS, INC.,
Respondent.

BRIEF IN OPPOSITION TO THE PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

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To The Honorable Chief Justice and the Associate Justices of the United States Supreme Court:

Respondent, C. Wylie Allen, Trustee in Bankruptcy, submits that this Court should deny the petition for a writ of certiorari, filed by Commercial Credit Corporation, to review the decision of the United States Court of Appeals for the Seventh Circuit, affirming the Order of the United States District Court for the Northern District of Illinois, Eastern Division, affirming the Opinion and Findings of the Referee in Bankruptcy, denying Petitioner's claim to a lien, valid in bankruptcy, under Section

10 of the Illinois Trust Receipts Act (Petitioner is hereinafter sometimes referred to as Commercial, while C. Wylie Allen, Respondent, is referred to as Trustee in Bankruptcy as distinguished from the trustee in a trust receipt transaction).

QUESTIONS PRESENTED FOR REVIEW.

(a) Whether this Court should review by certiorari the decision of the Court of Appeals affirming the District Court Order which affirmed the Referee's decision that Section 10 of the Illinois Trust Receipts Act does not grant a lien on general, free assets, valid in bankruptcy.[1]

(b) Whether Section 10 of the Illinois Trust Receipts Act grants a lien in the general, free assets of a borrower trustee where the trust goods are sold and the proceeds are spent (a criminal act under Illinois law); or does Section 10 merely grant a priority in payment in such event.

(c) If such a lien on free assets as Commercial claims, is granted by Section 10, is such a lien valid in bankruptcy, or is it voidable under:

1. Section 64 of the Bankruptcy Act which governs priorities in the distribution and which invalidates state priorities.

2. Section 60 of the Bankruptcy Act, as a contractual lien voidable as an illegal preferential transfer.

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[1] The lien or security interest of a trust receipt in the article or goods financed and the proceeds, upon the sale thereof was not involved in this Appeal. Commercial claims the trust receipt lien shifts from the trust goods to the proceeds and when the proceeds are spent that the lien shifts or transfers to the general, free assets.

3. Section 67c(2) of the Bankruptcy Act, as a statutory lien voidable by reason of insolvency and absence of possession.

4. Section 70 of the Bankruptcy Act as a voidable lien under federal and state law applicable to the facts.

STATEMENT.

For further clarification of the issues involved, Respondent submits the following additional facts.

On July 20, 1957, Commercial repossessed all of its trust cars from the bankrupt, Crosstown Motors, Inc. These cars are not involved in this controversy. On July 22, 1957, Crosstown made an assignment for the benefit of creditors. Commercial attended a meeting of creditors convened on July 29, 1957. On August 6, 1957, an involuntary petition in bankruptcy was filed against Crosstown, a receiver was appointed and he took over all of the general, free assets of the bankrupt from the Assignee and sold them at public auction on August 13, 1957. Commercial attended that auction sale of the free assets and made no objection or claim to the property being sold or its proceeds. Four months later, in December of 1957, Commercial first made its claim under Section 10 of the Illinois Trust Receipts Act. This is in contrast to its prompt and immediate repossession of its trust cars.

To the Petition of Commercial for a lien, the Trustee in Bankruptcy and the Petitioning Creditors, with leave of Court, filed Answers denying Commercial's claim to a lien on the general, free assets or their proceeds and alleged that Section 10 does not provide for a lien, but for a state created priority, and that if it did provide for a lien, it would be voidable in bankruptcy under Sections 60, 64, 67 and 70 of the Bankruptcy Act. The Trustee in

Bankruptcy also filed a Counter Claim for some payments made on an open loan and for ten trucks which were the free property of Crosstown. Just prior to bankruptcy, Commercial extracted trust receipts from Crosstown on these ten trucks, took possession of them of them and sold them for Five Thousand Two Hundred Fifty And No/100 ($5,250.00) Dollars. The Referee held this to be an illegal preference under Section 60 of the Bankruptcy Act and sustained the Trustee's Counter Claim for one monthly payment and for the value of the ten trucks. Commercial, at Page 4 of its Petition, accepts this ruling of the Referee as to the Counter Claim and concedes the validity of the ruling requiring Commercial to return the proceeds of the trucks, as well as one monthly payment as illegal preferences.

The Referee denied Commercial's claim to a lien under Section 10 of the Illinois Trust Receipts Act on the basis that said Section does not provide for a lien, but provides for a priority, void in bankruptcy, and further, that if construed as providing for a lien, such lien would be voidable under Sections 60 and 67c(2) of the Bankruptcy Act. The Referee's Opinion is attached hereto as an Appendix to this Brief.

Commercial filed a Petition for Review of the Referee's Order to the District Court and the ruling of the Referee was affirmed.

Commercial filed an Appeal to the Court of Appeals and in an unanimous opinion the Court of Appeals affirmed the District Court. Commercial filed a Petition for Rehearing which was denied.

REASONS FOR DENYING THE WRIT.

(1) There is no conflict in the decision of the Court of Appeals below with the decision of any other Court of Appeals.

There is likewise no conflict in the decision of the Court below with those decisions of the state court cases in Indiana[2], Tennessee[3], and Idaho[4] cited at Page 5 of Commercial's Petition. As the Court below held, those cases do not involve bankruptcy, and they can be resolved on the basis of Section 10 granting a priority which a state court would be obliged to recognize, and did recognize in those cases.

As for the claimed conflict between the decision of the Court of Appeals in the instant case and the District Court of Tennessee in the matter of *In re Harpeth Motors, Inc.*, 135 F. Supp. 863 (D.C. Tenn. 1953), while the latter case involved bankruptcy, that Court construed Section 10 under Tennessee law, while in the instant case Section 10 was construed in the light of Illinois law which does not favor "floating liens" or general liens on a stock of merchandise subject to sale. *Huschle* v. *Morris*, 131 Ill. 587, 591. Furthermore, the *Harpeth* case can be distinguished from the instant case in that it did not consider any defense to the claim to a lien, based upon Section 60, 67c(2)[5] or 70 of the Bankruptcy Act. In addition, the

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[2] **Universal Credit Co. v. Citizens State Bank**, 224 Ind. 1 64 N.E. 2d 28.

[3] **Commerce Union Bank of Nashville v. Alexander**, 312 S.W. (2d) 611.

[4] **Commercial Credit v. Bosse**, 283 P. 2d 937.

[5] The **Harpeth** case construed Section 10 as creating the purported lien making it a statutory lien (Pet. Appendix, p. 17a). As a statutory lien, it would be invalid under 67c(2). The Court in the **Harpeth** case did not apply Section 67c(2). This could be because the **Harpeth** case was filed in 1949 while Section 67c(2) was enacted in 1952.

Harpeth case makes no reference to the historical background of the adoption of the Uniform Trust Receipts Act in 1933 when state created priorities were valid and when there was no need to provide for a lien. It makes no reference to the Congressional policy of vesting control over distribution in the bankruptcy court. Collier On Bankruptcy, Vol. 3, p. 2052 and Vol. 4, p. 205.

The Florida District Court case of *English* v. *Universal-C.I.T. Corporation,* D.C. Southern District of Florida, Miami Division 8929M-Civil cited by Commercial as conflicting, merely followed the decision of the *Harpeth* case as providing a lien, without any consideration or analysis of Section 10 as a lien or priority provision, and without any consideration of Section 60, 67c(2) or 70 of the Bankruptcy Act as possible invalidating clauses. Furthermore, in the Florida case, the finance company took possession of the general, free assets *prior* to bankruptcy so that it is distinguishable on the facts from the instant case.[6]

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[6] At the time of the writing of this Brief, the English case is pending on Appeal in the Fifth Circuit Court of Appeals. If it is reversed, the effect will be to overrule both the **Harpeth** and **English** decisions and there will be no conflict whatsoever so that the Petition for certiorari should be denied. If it affirms, there is still no conflict as the facts in that case are different. Furthermore, it is submitted, that certiorari should be denied here, in any event, because the decision below is correct.

The articles cited by Petitioner in the Harvard Law Review[7] and the Yale Law Journal[8], as well as all the cases relied upon by petitioner, all fail to note the historical background of the Uniform Trust Receipts Act. As the Court of Appeals in the instant case correctly held, in 1933 when the Uniform Trust Receipts Act was adopted, state created priorities were recognized in bankruptcy so that there was no necessity for the authors to provide for a lien. All that they had to do was to provide for a priority and this they did by entitling Section 10 as, *"Entruster's Rights to Proceeds"* and by the wording of Section 10 wherein the word lien is totally absent and the words security interest are used only in a modifying clause. This state created priority was subsequently eliminated by the Chandler Act of 1938, Collier on Bankruptcy, Volume 3, Page 2052, Vol. 4, p. 205.

The decision below being the only opinion of any Court of Appeals on the question at issue, and the District Court and state court cases relied upon by petitioner being in fact distinguishable from the case below, there is accordingly no basis for granting Commercial's request for certiorari on the grounds stated in its first reason.

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[7] No authors are named in these articles and both acknowledge the difficulty of resolving the issue. See p. 25a of Pet. Appendix where the author says that the Court in the **Harpeth** case "seems correct in holding that the finance company had a general lien", but no case is cited to support such conclusion.

[8] The Yale L.J. at p. 30a of Pet. Appendix refers to "unclear language of Section 10 and the paucity of judicial interpretations, it is yet uncertain whether Section 10 authorizes a lien on unidentifiable proceeds and whether such a lien is enforceable in bankruptcy". Neither of these articles applied Section 60 of the Bankruptcy Act.

(2) For answer to Petitioner's second ground for certiorari, as to the importance of the question presented, we submit that the question presented is inconsequential for the following reasons:

(1) The absence of any provision for a lien on the general, free assets of the borrower in the detailed, lengthy, fine print of the trust receipt which spells out the lien in the trust property and proceeds, or in the statement of trust receipt financing which is filed with the Secretary of State;

(2) The absence of any language spelling out a lien or security interest on general, free assets in Section 10 of the Trust Receipt Act, despite the fact that the words "lien" and "security interest" are defined and repeatedly used in other sections of the Act;

(3) the total absence of such a lien on the general, free assets as claimed by Commercial, in the common law decisions applicable to trust receipt financing prior to, and in the absence of, statutory regulation;

(4) the paucity of cases involving the issue herein presented, for it is an extremely rare case where a borrower commits the criminal act of selling trust property, does not account for the proceeds and then becomes a bankrupt. (There are only three cases involving this issue in bankruptcy, the *Harpeth* case, the *English* case and the instant case, since the adoption of the Uniform Trust Receipts Act in 1933);

(5) the decision in question has had no effect, whatsoever, on trust receipt financing. Were the effect of this decision, to seriously impair the rights of the entruster finance company in its intended security as claimed, there would have certainly been many, and loud protests, and a

substantial curtailment in such financing, and that is certainly not the case.

At Page 6 of its Brief, Commercial states that "unless this decision is reversed it will require the amending of Section 10 of the Uniform Trust Receipts Act in 35 States and in Puerto Rico" and that banks and financing companies "will be forced to withdraw this type of credit unless the courts and legislature provide protection". This is an incredible statement without any basis whatsoever. It is an attempt to confuse the issues by assimilating the lien against the trust goods with a purported lien against general, free assets. Protection is provided to the banks and financing companies in accordance with the terms of their trust receipt contract and the statute which provide for a lien or security interest in the trust property and proceeds. To extend this protection to a lien or security interest in general, free assets, is first of all, primarily, a matter for the legislature. Secondly, one would expect that if the lien in general, free assets is the "life blood" of trust receipt financing as Commercial claims at Page 6, it would have been provided for in the trust receipt or in the statutes in clear, unequivocal language. It appears from the record that the claim to a lien in the general, free assets was an afterthought in the instant case, (App. p. 152) as well as in the *Harpeth Motors* case, wherein the petition of the finance company was framed on the theory of a priority and not that of a lien. (See Pet. Appendix p. 22a).

It is respectfully submitted that the second grounds for certiorari asserted by Commercial are erroneous in fact and in the conclusions sought to be drawn from them.

(3) In its third ground for certiorari, Commercial asserts that the decision below is erroneous and that the conflicting decision of Harpeth Motors, supra, is correct. It is respectfully submitted, that the decision of the Court of Appeals below is correct and that the District Court decision in the Harpeth Motors case, if it conflicts, is erroneous for the reasons given above at p. 6.

The fact that other states adopted the Uniform Trust Receipts Act after the Chandler Act was passed in 1938, has no bearing on the questions at issue. The States adopted the Uniform Act in the same form, including Section 10, as it was drafted by the Authors in 1933, without any clear understanding of Section 10, except that it provides for a priority to the entruster as to proceeds of trust property in state liquidations and in bankruptcy. That is the plain wording of Section 10 and it clearly has no provision for a lien on general, free assets. To arrive at the intent of the legislators who adopted the Uniform Act, we must look to the intent of the authors of the Uniform Act. For such purpose we consulted the Handbook of the National Conference of Commissioners on Uniform State Laws on Trust Receipts, 1933. At p. 250 the following appears:

> "The Act on a number of points simplifies otherwise expensive administration of insolvent Estates e.g. *Section 10 (B)*"

At p. 251:

> "In the event of a Trustee insolvency, it simplifies the proof in administration proceedings by allowing a *preference* for any proceeds of released security which had been received by the Trustee within ten days so far as the Trustee was under a duty to account for such proceeds. Section 10 (B)" (Emphasis added)

Nowhere in the entire Handbook or in any articles or notes on the Uniform Trust Receipts Act is there any reference to Section 10 giving rise to a lien on general, free assets.[9]

The Authors of the Act having intended to create a priority by Section 10, such must be its construction; and as a state created priority, it must be construed to be subordinate to Section 64 of the Chandler Act of 1938. This Section was aimed at eliminating state created priorities which were exhausting bankruptcy estates and leaving no funds for payment of costs of administration, wages or taxes. Collier on Bankruptcy, Vol. 3, Page 2052; Vol. 4, p. 205. The claim that Section 10 gives rise to a "lien" and not a state created priority was first advanced, as an afterthought in the *Harpeth Motors* case in 1955, long after most of the states had adopted the Uniform Trust Receipts Act so that the various legislatures actually never had the problem for consideration. There is ac-

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[9] Professor G. G. Bogart of the University of Chicago, one of the commissioners who drafted the Uniform Trust Receipts Act, in an article in the University of Chicago Law Review, Volume 3, Page 29, December 1935, says that Section 10 "grants preferred claims to the lender". No reference is made in his article to Section 10 giving a lien on general, free assets and a "preferred" claim is certainly not a "lien" claim.

As a further aid to construction of Section 10, we have the extremely rare case of a legislator instrumental in the adoption of an Act, and subsequently, upon his elevation to the bench, being called upon to construe that same legislation. Circuit Judge Elmer Schnackenberg, who joined in the unanimous opinion of the Court of Appeals below, was a member of the Illinois legislature which enacted the Illinois Trust Receipts Act in 1935, and at the time of oral arguments in the instant case, he stated that the Act was difficult to comprehend and was adopted in reliance upon the recommendation of the authors and not upon the basis of the understanding and intent of the members of the legislature.

cordingly no basis for Commercial's allusion at Page 7, to the "collective stupidity of the state legislators" who enacted the Trust Receipts law. There is also no basis for Commercial's reference to the "collective stupidity" of the many able lawyers who composed the National Conference of Commissioners on Uniform Laws inasmuch as stated above, all of the evidence in point is, that they considered Section 10 as giving rise to a priority and not a lien. All that was required in 1933 when the Act was adopted was a priority, for state priorities had to be recognized in bankruptcy prior to 1938.

The Referee in the instant case did not make a mistake as claimed by Commercial at Page 7. His Opinion, attached hereto in the Appendix, clearly reflects his grasp and understanding of the issues and their correct determination in accordance with the true intent of the Illinois Legislature and in conformance with Congressional policy of making Section 64 of the Bankruptcy Act paramount in the distribution of an insolvent estate in bankruptcy.[10]

The District Judge, who affirmed the Referee's decision in the instant case, although a "recent appointee", as Commercial claims at Page 8 of its Brief, was a Circuit

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[10] Such Congressional policy has been followed to the point where state statutes having a "label" or "tag" as a lien claim are construed to be, in fact, priorities, hiding under the guise of liens and as such, subordinate to Section 64 of the Bankruptcy Act. Strom v. Pikes, 123 F. 2d 1003; Collier On Bankruptcy, Volume 4, Page 205; 51 Yale Law Journal, Page 863; Commercial Clearing House Bankruptcy Law Reporter, Volume 1, Page 7192, Paragraph 6044. It is respectfully submitted that if a statute bearing the label or tag of a lien can be held to be subordinate to Section 64 of the Bankruptcy Act, how much more reason is there to deny a claim to a lien based upon Section 10 where the word lien is totally absent and Commercial attempts to "read into" the statute, by interpolating the same result as if the statute provided for a lien?

Court Master in Chancery and a Judge of the Circuit Court of Cook County, Illinois, for over 20 years prior to his appointment. He is one of the most able legal scholars in Illinois and the reference to his inexperience is contrary to fact.

Commercial's reference to Judge Parkinson's adopting the Referee's opinion at Page 8 of its Brief is not correct. He wrote his own opinion, which was joined in by Circuit Judge Earl Major, former Chief Justice and Senior Judge of the Seventh Circuit, as well as Judge Elmer Schnackenberg who served as Speaker of the House in the Illinois Legislature, and as a Circuit Court Judge for many years prior to his elevation to the Appeals Court.

It is respectfully submitted that the third grounds for certiorari alleged by Commercial are erroneous for the reasons hereinabove set forth.

(4) In its fourth reason for certiorari, Commercial restates its second ground, namely, the purported important effect of the decision in question on trust receipt financing. Reference is made to the decision below being a "mortal wound" inflicted upon the Uniform Trust Receipts Act. (Page 9 of Brief). This is not true.

Commercial is confusing the issue and is attempting to lead this Court into a misunderstanding of what is at issue in this case.

The 1950 Amendment to the Bankruptcy Act, referred to at Page 9 of Commercial's Brief, had to do with validating the lien of the trust receipt as to the trust property and proceeds in bankruptcy. It had nothing at all to do with any lien or a claim to a lien on general, free assets. That Amendment removed any question as to the validity of the lien of the trust receipt as to the

trust property. The decision here has no bearing upon that question, or upon the Amendment of 1950.

Finance companies engaging in trust receipt financing rely upon the trust property and its proceeds for protection. This is clear from the form of the trust receipt which is devoid of any provision for a lien on general, free assets. The conclusion drawn by Commercial at Page 10 of its Brief, that denial of its claim to a lien on general, free assets will result in a substantial withdrawal of over Twelve Billion Dollars of automobile trust financing, as well as other forms of such financing, is absurd and without any foundation whatsoever.

Commercial implies at Page 10 of its Brief that the decision below takes away protection vitally needed by lending agencies. In the instant case, Commercial was permitted to repossess almost $200,000.00 worth of its trust cars from the bankrupt without question. It is accordingly quite clear that the case below does not affect the lien of an entruster in the trust property and its proceeds. It is only in the extremely rare case of a bankrupt, out of trust and without proceeds of the trust property that the entruster is denied the right to take over the general, free assets of a bankrupt to the exclusion of wage earners, tax claimants and costs of administration. The comparatively very small loss sustained in such rare cases as the instant one by finance companies would hardly warrant the withdrawal of such form of financing, as contended by Commercial and the resulting loss of the huge profits to the finance companies from such form of financing.[11]

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[11] This claim to protection by way of a lien on general, free assets where security is dissipated, is unknown to security financing by way of chattel mortgage, conditional sale, accounts receivable discounting or trust receipt. Where a lien

The accusation of Commercial that the Referee, the District Judge and the three members of the Court of Appeals made erroneous deductions and conclusions based upon total unfamiliarity with the purposes of the Uniform Trust Receipts Act as pertaining to bankruptcy at Page 10 of its Brief and the claim of Commercial that Judge Parkinson "was not physically able at the time he wrote his opinion to give the question considerate study and analysis", are clearly indicative of the absence of any valid reasons shown by Petitioner for certiorari. There being a total absence of valid, legal grounds for certiorari, Commercial has resorted to attacks upon the ability of the Referee and the District Judge, and to criticism of the physical fitness of the Circuit Judge who wrote the opinion.

The Referee's Opinion attached hereto as Appendix "A" speaks for itself as to his ability, his understanding of the issues, and his knowledge of the applicable law. As for the merits of the Opinion of Judge Parkinson, which was joined in by his two very able colleagues, it may also speak for itself as to the Court's understanding of the issues, the facts and the law applicable thereto. The claim that Judge Parkinson was not "physically able" at the time he wrote his opinion is pure conjecture, unwarranted by any facts or evidence other than mere newspaper reports of events which occurred at a much later date. Further-

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[11] Continued
on general, free assets is provided for, in a written contract as a substitute for dissipated security, such lien is invalid in bankruptcy as an illegal preference. **Sawyer v. Turpin,** 91 U.S. 114 23 L.Ed. 135; **Curtis v. Knox,** 254 F. 2d 433; **National City Bank v. Hotchkiss,** 231 U.S. 550.

more, such claim is an unwarranted reflection upon his two able colleagues who joined him in his opinion and who, at a later date, denied Commercial a rehearing in the matter.

Commercial at Page 10, accuses the Referee of being concerned with the fact that recognition of a petitioner's claim to a lien would leave no estate for the payment of costs and fees, and Commercial offers to stand some portion of such costs. This is a confession of error on its part. The Referee's Opinion is in conformance with Congressional policy establishing the paramount authority of Section 64 of the Bankruptcy Act in directing the order of distribution in an insolvant, bankrupt estate as against false claims to liens which are in reality, priorities. The Referee was concerned, not only with costs of administration, but more important, with a correct construction of Section 10 and also, with the payment of substantial tax claims due the government and wages due employees, none of which can be paid if Commercial's claim to a lien is recognized. Recognition of Commercial's claim would in effect open the doors to other financiers, either by contract or legislation, to attempt to grab the general, free assets of a bankrupt, leaving nothing for the payment of costs of administration, taxes, or wages. It would give rebirth to the same evil conditions which the Chandler Act and its Amendments were intended to eliminate.

It is respectfully submitted that the fourth grounds for certiorari are erroneous and do not warrant the relief requested.

CONCLUSION.

For the foregoing reasons, it is respectfully submitted, that the Petition for Writ of Certiorari should be denied.

Respectfully submitted,

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APPENDIX

REFEREE'S MEMORANDUM OPINION
(Filed 1-13-59)

This case presents two questions. The principal one is whether Sec. 10 of the Illinois Trust Receipts Act entitles Commercial Credit Corporation (herein called Commercial) to a lien in the sum of $50,578.24 upon the general assets of the bankrupt estate, prior and superior to the rights of the trustee in bankruptcy and to all costs of administration. The other question is whether certain transfers made by the bankrupt to Commercial within four months of bankruptcy constitute voidable preferences under Section 60(a) and (b) of the Bankruptcy Act, the value of which is recoverable by the trustee.

The basic facts are undisputed. In October, 1955, the bankrupt, a Ford dealer in Chicago, Illinois, entered into an agreement with Commercial for trust receipt financing or "floor plan accommodation". The requirement of filing the requisite statement with the Secretary of State was complied with.

Pursuant to such agreement, Commercial financed the purchase of automobile by the bankrupt through the use of trust receipts executed by the bankrupt as "trustee" and delivered to Commercial as "entruster".

The trust receipts used were printed forms supplied by Commercial, in which the trustee (bankrupt) granted to the entruster (Commercial) a "security interest" in the cars (merchandise) therein specifically described "with all attachments and equipment as a component thereof".

The trustee agreed thereby to hold such merchandise in trust for the entruster. The trust receipt further specified

that the trustee's possession was for the purpose of sale at retail but required the trustee immediately after sale to deliver to the entruster from the proceeds the amount of minimum sale price set forth in the trust receipt. Among other conditions specified therein, the trustee agreed to hold the proceeds "in trust" for Commercial "separate and apart from the funds and property" of the bankrupt until actual payment thereof to Commercial.

During the period of such trust receipt financing Commercial made frequent visits to the bankrupt's place of business and received monthly financial statements from the bankrupt. It also made periodic "car checks" about every two weeks; these were physical inspections or inventories of the automobiles which were covered by trust receipts held by Commercial. Their principal purpose was to make sure that the bankrupt had paid over the required proceeds to Commercial.

During the course of the trust receipt financing, Commercial on January 29, 1957, made an unsecured capital loan of $25,000 to the bankrupt, payable in 12 equal monthly principal installments of $2083.34 each, plus interest. The bankrupt made such monthly payments to Commercial in March, April, May, June and July, 1957, the last such payment being on July 16, 1957, in the sum of $2,166.67.

On July 12, 1957, Commercial made a "car check". This disclosed that the bankrupt had sold 18 cars "out of trust", namely without paying the proceeds to Commercial. The Commercial employees who made such car check requested the bankrupt to make an accounting of such proceeds in the sum of $37,330.82 and to pay that amount to Commercial. The bankrupt did not comply with the demand for payment.

On July 15, 1957, 3 days later, a similar car check by Commercial disclosed an identical shortage and the Commercial executives who were present made demand for accounting and payment in the same amount. However, the bankrupt was still without funds and unable to comply with the demand for payment. Instead, it requested more time, stating that it was trying to sell its business, from which it expected to realize enough to pay its liabilities.

On July 19, 1957, Commercial through some of its executives made a further "car check". This disclosed that 7 more cars were sold "out of trust", representing proceeds of $13,192.72, which should have been paid to Commercial. A further demand for accounting and payment was made. Again, the bankrupt was unable to, and failed to comply with, the demand for payment. By this time the aggregate amount owing to Commercial for cars sold "out of trust" was $50,578.24.

Although the bankrupt failed to pay any of the demanded sums to Commercial, it delivered to Commercial later in the day on July 19, 1957, a trust receipt covering 10 used trucks, which were owned by the bankrupt and located on its premises. This trust receipt was stated to have been given to Commercial in connection with earlier deficits which had been incurred in connection with the sale by the bankrupt of certain 1956 demonstrator cars (which were covered by trust receipts) for less than the amount which Commercial Credit had advanced thereon to the bankrupt.

On July 20, 1957, Commercial took possession of all of the remaining cars of the bankrupt which were subject to trust receipts, including the ten used trucks. Eventually it realized on the security of the trust receipts of the

new automobiles; the 10 used trucks were later sold by it at public sale for the sum of $5,250.00.

It is interesting to note that, although the receipt required the bankrupt to hold the proceeds "in trust" for Commercial, "separate and apart from the funds and property of" the bankrupt, until actual payment to Commercial, the bankrupt deposited all such proceeds from time to time in its general bank account, and against which it drew for all purposes, including operating costs and expenses. The bankrupt never maintained a separate bank account for such proceeds. Commercial had actual knowledge of this practice at all times, and never complained to the bankrupt or required the bankrupt to comply with the specific requirement to keep such proceeds separate.

On July 22, 1957, the bankrupt made an assignment of all of its assets for the benefit of its creditors. Gerald P. Grace was the assignee. Commercial received notice of such assignment on or about July 23, 1957, and on July 29th attended a meeting of the bankrupt's creditors called by the assignee. With the approval and consent of Commercial, as well as other creditors, Mr. Grace made arrangements for a public auction sale of the bankrupt's tangible assets, free and clear of liens, to be held on August 13, 1957.

On August 6, 1957, a petition for involuntary bankruptcy was filed to adjudicate Crosstown bankrupt and a receiver was appointed and duly qualified and an order of adjudication was entered on August 13, 1957. By order of this court, the receiver adopted the procedure initiated by the assignee for the public auction sale. Commercial, by its agent, was present at the receiver's sale. Gross proceeds of $31,000 were realized at the receiver's sale.

The size of the bankrupt estate, which has been substantially liquidated, representing the proceeds of sale and other liquidation by the trustee, is approximately $45,000 at this time.

Commercial filed no petition in this proceeding until December 4, 1957, when it asserted a lien, in reliance on Section 10 of the Illinois Trust Receipts Act, upon all of the assets in this estate, prior and superior to the rights of the trustee in bankruptcy, and ahead of costs and expenses of administration and all other priorities set forth in Section 64(a) of the Bankruptcy Act.

The trustee and petitioning creditors filed their answers and amended answers, alleging: (1) That Section 10 of the Trust Receipts Act did not set forth a right to a lien but at most to a priority; (2) that such priority was not effective as such under Section 64 of the Bankruptcy Act; (3) that if Section 10 of the Trust Receipts did create a lien, it was nothing more than a statutory lien and as such invalid against the trustee by virtue of the provisions of Section 67 (2) of the Bankruptcy Act; (4) that the lien asserted by Commercial would constitute a preference under Section 60(a) of the Bankruptcy Act and was not valid as such against the trustee by virtue of the provisions of that section and of Section 70 of the Bankruptcy Act.

The trustee also filed a counterclaim against Commercial in which he sought to recover the aggregate amount of $8,740.81, representing the aggregate of the monthly payments made within four months of the filing of bankruptcy on account of the unsecured capital loan above referred to and the value of the 10 used trucks covered by the trust receipt and trucks delivered by Com-

mercial by the bankrupt on July 19th and 20th, 1957, alleging that they were voidable preferences and not valid against the trustee.

No reported cases in Illinois have been called to the attention of this court, construing the effect of Section 10 of the Illinois Trust Receipts Act. Indeed, no cases have been cited construing its effect in bankruptcy by any courts in the Seventh Circuit.

The only case construing a similar provision in a bankruptcy case (which is relied on by Commercial) is *In re Harpeth Motors, Inc.*, D.C. Tenn., 1955, 135 F.Supp. 863. There, Judge Miller, in construing the Tennessee law and in particular, Section 10 of the Tennessee Trust Receipts Act, concluded that it was the legislative purpose of the Tennessee legislature to create a lien, not only on the proceeds derived from the sale, but also, on all other assets of the bankrupt in that case. In arriving at that conclusion, Judge Miller reversed the Referee who had denied the finance company's claim to a priority (not for a lien) in the distribution of the bankrupt's assets under that section. The Referee in his decision denying such priority called attention to the 1938 amendment of the Bankruptcy Act by the Chandler Act and, in particular, to the revision under that Act of Section 64 of the Bankruptcy Act. That revision, of course, eliminated state-created priorities, except in the case of rent. Collier on Bankruptcy, 14th Ed., Vol. 3, Page 2052.

While the *Harpeth* case may have properly interpreted the legislative intent of the Tennessee legislature in the enactment of the corresponding section of the Tennessee Trust Receipts Act, it is necessary in the instant case to ascertain the legislative intent of the Illinois legislature

when the Illinois Trust Receipts Act was adopted in 1935. It is particularly important to ascertain whether it was the legislative intent in Section 10 of the Illinois Trust Receipts Act to create a lien on the general assets superior to the rights of the trustee in bankruptcy and creditors.

In connection with such analysis, it may be well first to consider some of the provisions in the form of trust receipt involved in this case. It is a printed form prepared by Commercial in which the bankrupt, as "trustee", granted to Commercial, as "entruster", a "security interest" in the cars therein specifically described, with "all attachments and equipment as a component thereof". The bankrupt agreed thereby to hold said merchandise in trust for Commercial; his possession was agreed to be for the purpose of sale at retail. The trustee agreed to deliver to Commercial from the proceeds of sale such amount as was payable to Commercial thereunder. The trust receipt says nothing about any lien or security interest in any other assets or property of the borrower.

The Illinois Trust Receipts Act has been frequently described as being very complicated and difficult to understand. It differs from the Uniform Trust Receipts Act in several material respects. Bogert, The Effect of the Trust Receipts Act, 3 Univ. of Chicago L. Rev. p. 26 (1935). Indeed Governor Horner of Illinois, when he permitted the bill to become law on July 1, 1935, without his signature, in the memorandum which he filed at that time with the Secretary of State, stated as follows:

> "The law * * * is a very complicated and technical act, the purposes of which are not readily discernible. * * * In view of the complicated nature of the Bill and of the short time I have at any disposal for consideration of the same, I am impelled to rely upon the legislative judgment, and I am therefore constrained to file the same without my signature."

Section 1 of the Illinois Trust Receipts Act (Chap. 121½, Section 166, Illinois Revised Statutes 1957) defines "security interest" as follows:

> "(12) Security interest means a property interest in goods, documents or instruments, limited in extent to securing performance of some obligation of the trustee or of some third person to the entruster, and includes the interest of a pledgee, and title, whether or not expressed to be absolute, whenever such title is in substance taken or retained for security only."

Other sections of the act are concerned with the requirement and effect of the filing of a trust receipt financing statement with the Secretary of State, the validity of such security interest against creditors, and provide for a limitation on the entruster's security interest purchasers from the borrower.

Section 10 of the Act which is entitled "Entruster's right to proceeds" provides in part as follows:

> " • • • the entruster shall be entitled • • • (b) to any proceeds or the value of any proceeds (whether such proceeds are identifiable or not) of the goods • • •, if such proceeds were received by the trustee within ten days prior to • • • the filing of a petition in bankruptcy • • • by or against the trustee, or demand made by the entruster for prompt accounting; and to a priority to the amount of such proceeds or value."

Clearly the intent of this section is to entitle the lender to the proceeds or the value of proceeds of goods covered by trust receipts under the stated circumstances, and in the event of the borrower's bankruptcy to a priority to the amount of such proceeds. The only reference to a security interest in that section is in a modifying provision which defines the extent to which, and the parties as to whom, the lender is entitled to such proceeds.

Section 11 of the Illinois Trust Receipts Act uses the word "lien" in its caption. It permits the borrower to create contractual liens upon the goods covered by the trust receipts in the usual course of his business which would be valid against the subject matter of such trust receipts, without creating a personal liability on the part of the lender for the debt secured thereby.

An analysis of the provisions of the Illinois Trust Receipts Act makes it clear that it was not the intention of the Illinois legislature in enacting the Trust Receipts Act to create a lien valid in bankruptcy against the rights of the trustee in bankruptcy, against the general assets of the bankrupt-borrower's assets but only to create a preference or priority in the distribution of such assets.

That this was not the intention of the Illinois legislature and of the framers of the Uniform Trust Receipts Act, in Section 10 of the Act as adopted in Illinois, is further indicated by an analysis of the effect of the Trust Receipts Act by Professor Bogert of the University of Chicago Law School in an article which appeared in the December, 1935, issue of the University of Chicago Law Review. 3 Univ. of Chicago Law Rev. pp. 26 and 38. That article was written a few weeks of the enactment by the Illinois legislature of the Trust Receipts Act and of the action by Governor Horner in permitting the bill to become law July 1, 1935, without his signature. In that analysis, Professor Bogert in discussing the enforcement of trust receipts under the Act, states in part as follows:

> "If the subject matter was sold under a power of sale in the borrower, where there was a duty to account to the lender for the proceeds of such sale, the lender is entitled, if the borrower defaults in his obligations, to the debt from the buyer of the goods

and to the proceeds of the goods (or the value of the proceeds), if received by the borrower within ten days of receivership or bankruptcy.

These provisions grant preferred claims to the lender under the trust receipt. * * *"

No reference is made to a lien or security interest in general assets, only to "preferred claims".

Relevant footnotes to the material above quoted call attention to an omission from the Illinois Act of a provision in the Uniform Act regarding waiver of a right to an accounting, and to the inclusion in the Illinois Act of a section not found in the Uniform Act, namely Section 30, which makes misappropriation of the proceeds of goods by the borrower a felony. A further footnote calls attention to the case of *Hamilton National Bank* v. *McCallum*, 58 F. (2d) 912 (C.C.A. 6th 1932) in which it was held under Tennessee law, before the enactment by Tennessee of the Uniform Trust Receipts Act, that the holder of a trust receipt was the owner of proceeds of goods sold by a bankrupt as against his trustee in bankruptcy. In that connection it should be noted that the decision in the *Hamilton* case interpreted the Tennessee law as it was prior to the enactment of the Trust Receipts Act in Tennessee. This may afford an explanation for Judge Miller's ruling in the *Harpeth* case.

From the foregoing analysis of the Illinois Trust Receipt Act, it is the conclusion of this court that Section 10 of that act did not create a lien, but at most a right to priority in the event of bankruptcy or insolvency. While such state-created priority would have been valid and enforceable in bankruptcy until the enactment by Congress of the Chandler Act of 1938 and particularly the revision therein made in Section 64 of the Bankruptcy Act, sub-

sequent to that amendment, such state-created priority cannot be recognized and is held to be invalid and ineffective.

The foregoing conclusion would be decisive on the principal question in this case, namely, the effect of Section 10 of the Illinois Trust Receipts Act as against the rights of the trustee in bankruptcy. However, in view of the persuasive, though not conclusive, effect of a decision of the United States District Court in another jurisdiction involving a question of state law (the *Harpeth* case), it may be advisable to make a further analysis of the law on the assumption that the decision in that case would be applicable to the facts of this case.

Therefore, for the sake of such analysis, let it be assumed that the legislative purpose of Section 10 of the Illinois Act was to, and that it did, create a lien in favor of the lender on the general assets of the bankrupt estate, superior to the rights of the trustee in bankruptcy. It would then become necessary to consider when such lien arises. Reference, therefore, must again be made to the complicated wording of Section 10 of the Illinois Act. From that it will be observed that the right to the proceeds or to such security interest or lien, as they may be available, and to the priority or lien against the general assets in the amount of such proceeds, would arise only by virtue of the demand for accounting and payment made within ten days of the receipt by the borrower of such proceeds. In such case, Commercial's lien, if any, would have arisen in this case early in July, 1957, the demands for accounting and payment having been made in July 12, 15 and 19, 1957. As stated above, bankruptcy occurred in August, 1957. It is obvious, therefore, that the lien, if such it was against the general assets of the

bankrupt estate, would have arisen within four months of bankruptcy.

Section 67 c (2) of the Bankruptcy Act, which was added by an amendment of the Bankruptcy Act in 1952, invalidated as against the trustee all statutory liens created or recognized by state law, on personal property not accompanied by possession, levy, sequestration or distraint. Its obvious purpose was to further the policy recognized by prior amendments to protect unsecured creditors against state-created priorities and "floating" liens thought to be essentially indistinguishable from priorities. 4 Collier on Bankruptcy, 14th Ed., p. 195.

It, therefore, becomes necessary to consider whether the lien claimed under Section 10 of the Illinois Trust Receipts Act is contractual, or whether it is a statutory lien within the provisions of Section 67c(2) of the Bankruptcy Act. There can be no question but that the lien of the trust receipt is a contractual lien, insofar as it covers the specific goods or merchandise therein described. As noted above, in the trust receipt here used, the borrower granted to the lender a "security interest" or lien in the specific goods therein described, together with "all attachments and equipment as a component thereof". To the extent, however, that Commercial relies on the provisions of the statute, namely Section 10 of the Illinois Trust Receipts Act, for the creation of a lien by virtue of the provisions of that statute and which arises within four months of bankruptcy, no other conclusion is possible but that that would be a statutory lien. As such it would fall within the purview of Section 67c(2) of the Bankruptcy Act and would be invalid against the trustee in bankruptcy.

Thus, even if it would be assumed that a lien was intended to be given by Section 10 of the Trust Receipts

Act, such lien would be invalid against the general assets of the bankruptcy estate. The bankrupt was insolvent on and after July 1, 1957, which was prior to the effective date of any demand made by Commercial here. Commercial did not have possession of the assets of the bankrupt. Such lien, if any, would have come into being merely by virtue of the economic relationship between the parties, namely the lender-entruster (Commercial) and the borrower-trustee (the bankrupt). The only basis on which Commercial could claim a lien is not the trust receipts used here, but Section 10 of the Illinois Trust Receipts Act. All of the actions taken, were within the four month period prior to bankruptcy. The fact that the trust receipts in question contained a provision giving both the borrower and lender "such other and further rights as may be provided by law" is not equivalent to a contractual lien on general assets; on the contrary, it merely emphasizes that in order to assert its right to a lien, Commercial would have to rely on the statutory provisions of Section 10.

Furthermore, the very facts in this case indicate that Commercial had no notion (until it filed its petition on December 4, 1957) of any right to a "lien" or "security interest" against the general assets of the estate superior to the rights of creditors or the trustee in bankruptcy. If it had any such notion, Commercial would certainly not have found it necessary or expedient to take on July 19 and 20, 1957, as it did, from the bankrupt the trust receipt and possession of 10 used trucks, which it later sold for $5,250. Likewise, Commercial would not have acquiesced, as it did, in the assignment which the bankrupt made on July 22, 1957, of all its assets for the benefit of all of its creditors; instead Commercial would have prevented, or at least strenuously objected to, such assign-

ment, because it would have asserted a lien, if it had believed it had one, against all the bankrupt's assets, in reliance on the provisions of Section 10 of the Trust Receipts Act. By the same token, Commercial would not have consented, but would have strenuously objected, to the bankruptcy sale of the bankrupt's assets on August 13, 1957, free and clear of all liens.

Thus, even Commercial's failure to assert its claim to a lien on the general assets of the bankrupt estate superior to the rights of the trustee in bankruptcy until its petition was filed on December 4, 1957, negates any nation on its part as to the existence of any lien. Its action in filing its petition several months later appear to have been but an afterthought.

In addition, it may be interesting to note that, although the bankrupt was required by the express terms of the trust receipt to keep the proceeds of cars covered by trust receipts separate from its other funds and property, Commercial, in full knowledge of the bankrupt's failure to comply with the terms of such requirement, acquiesced in the bankrupt's commingling of such proceeds with its general funds, and never required the bankrupt to comply with the express terms of the Trust receipt.

Although any further discussion is unnecessary, it may be well to add that even if Section 10 of the Illinois Trust Receipts Act could have been considered to have created a contractual lien (rather than a statutory lien) upon the general assets of the bankrupt estate, over and above the specific cars or goods covered by the trust receipts and the proceeds therefrom, such lien would be invalid as a preference under Section 60(a) of the Bankruptcy Act; obviously it would have been effected within the four

months period of bankruptcy, for an antecedent debt, while the debtor was insolvent, at a time when Commercial had reason to believe that the debtor was insolvent, and it would have enabled Commercial to obtain a greater percentage of its debt than some other creditor of the same class.

For the foregoing reasons Commercial's amended petition asserting a lien against the general assets of the bankrupt estate under Section 10 of the Illinois Trust Receipts Act must be overruled and denied. In view of this conclusion, it is unnecessary to decide the other questions raised by the parties in their pleadings, except that each of the demands made by Commercial, including the demand made on July 12, 1957, for an accounting and payment were adequate under Section 10 of the Illinois Trust Receipts Act.

There still remains for consideration the question raised by the trustee's counterclaim as to whether certain transfers constitute voidable perferences under Section 60(a) and (b) of the Bankruptcy Act. During all material dates Commercial received monthly statements of the bankrupt's financial condition and made frequent visits to the bankrupt's premises. Several witnesses testified as to such financial statements and their interpretation. From such testimony the Court finds that the bankrupt was insolvent on July 1, 1957, and thereafter, and that certainly on July 12, 1957, when Commercial made a "car check" and demand of the bankrupt for an accounting and payment, which the bankrupt was unable to comply with, Commercial had reason to believe that the bankrupt was then insolvent. In view of such finding, the payment made by the bankrupt on July 16, 1957, within four months of bankruptcy, in the sum of $2166.67 on account of the unsecured capital

loan which Commercial had made to the bankrupt, was and is a preference within the meaning of Section 60(a) of the Bankruptcy Act, void against the trustee, and the trustee is entitled to recover the amount thereof from Commercial under Section 60(b) of the Bankruptcy Act. In view of the foregoing findings, none of the earlier payments made by the bankrupt to Commercial constituted such preferences, and the trustee is not entitled to recover any of them from Commercial.

The trustee's counterclaim also sought to set aside and recover the value of the property involved in the transfer made by the bankrupt by the delivery of a trust receipt on July 19, 1957, covering 10 used trucks, and the delivery of possession of such trucks on July 20, 1957, to Commercial. In view of the foregoing findings as to insolvency, and the finding that Commercial had reason to believe the bankrupt to be insolvent, such transfers constitute a preference within the meaning of Section 60(a) of the Bankruptcy Act and, therefore, are declared to be void against the trustee. The trustee is therefore entitled to recover from Commercial under Section 60(b) of the Bankruptcy Act the value of such trucks.

The only evidence of such value on which this Court can rely relates to the public sale conducted by Commercial of such trucks, at which the sum of $5,250 was realized. The only other evidence adduced as to value was testimony by the manager of the bankrupt that prior to bankruptcy he had received an offer of $6,000 for such trucks, which was never consummated. This court, of course, cannot speculate as to whether the offer was bona fide and since it was not accepted, whether it would have been consummated. It, therefore, must be rejected as a measure of the value of the trucks in question. The Court

finds, therefore, that the sum of $5,250 represents the fair value of the 10 used trucks involved in that preference. The trustee is also entitled to recover that sum from Commercial.

Pursuant to Rule 52 of the Federal Rules of Civil Procedure, there will be filed concurrently with this memorandum Findings of Fact, Conclusions of Law, and an Order in accordance therewith.

Filed, this 13 day of January, 1959.

/s/ Stephen R. Chummers
Referee In Bankruptcy.